

CDFI Market Conditions First and Second Quarters 2012

Report I - Results and Analysis Published November 2012

The Opportunity Finance Network CDFI Market Conditions Report is a quarterly publication based on quarterly surveys of community development financial institutions (CDFIs). Opportunity Finance Network began conducting these surveys in October 2008 to better understand the impacts of tight credit markets and the economic downturn on the opportunity finance industry. Each report provides a near-real-time view of market conditions and CDFI responses, analysis of regional and financing sector differences, and analysis of important trends.

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EXECUTIVE SUMMARY¹

Through the first and second quarters of 2012, the national economy and employment continued to show improvement. Gross domestic product (GDP) grew at a rate of 2.0% in the first quarter and 1.3% in the second quarter as compared to the prior period. These rates were lower than the 4.1% achieved in the fourth quarter of 2011. In the first quarter, the unemployment rate dropped from 8.5% at the end of 2011 to 8.2% and remained there in the second quarter.

The percentage of FDIC-insured institutions that reported loans and leases 31 days or more past due decreased from 5.44% in the fourth quarter 2011 to 5.32% in the first quarter of 2012 and 5.00% in the second quarter.² The delinquency rate for loans on one-to-four-unit mortgages decreased to a seasonally adjusted rate of 7.40% of all loans outstanding as of the first quarter of 2012, a decrease of 18 basis points from the fourth quarter of 2011. The delinquency rate increased during the second quarter to a seasonally adjusted rate of 7.58%, an increase of 18 basis points from the first quarter.³

The key findings from the first and second quarter 2012 CDFI Market Conditions Surveys show continued solid demand for loans and strong originations as well as strong results for liquidity and earnings. There are signs that CDFIs are again becoming capital-constrained.

Demand for Financing and Loan Originations

Demand for financing remained strong and is stabilizing for more CDFIs. The percentage of respondents experiencing an increase in the number of financing applications received year-over-year remained over 50% as it has since the second quarter of 2011. The percent experiencing no change increased to above 20% in the first and second quarter, both higher than the last three quarters of 2011. The percent reporting decreases fell below 2011 levels.

Originations are similarly strong and stabilizing. CDFIs with year-over-year increases in originations fell from 60% in the last two quarters of 2011 to 48% in the first quarter before rebounding to 56% in the second quarter. These rates are comparable to the first and second quarters of the previous year. Like the experience with financing applications, in 2012 the percent reporting no change in originations year-over-year was higher than the last two quarters of 2011

Strong demand is expected to continue. Approximately 70% expected an increase in demand for financing in the next quarter (73% in the first quarter and 69% in the second quarter), rates that are either at or above the long-term average of 69%.

Capitalization and Liquidity

Few CDFIs expect an unrestricted loss in the current fiscal year. In the first and second quarter, the percentage of CDFIs expecting a decline in unrestricted net assets fell to 7%, the lowest since we began collecting these data in the fourth quarter of 2008. Both quarters are well below the average of 20% for the entire period analyzed and the 2008 high of 37%.

1 This report presents the results of the fifteenth and sixteenth consecutive quarterly CDFI Market Conditions Surveys conducted from April to May 2012 covering the first quarter (January– March) of 2012 and from July to August 2012 covering the second quarter (April– June). Detailed data tables are provided in the companion report, CDFI Market Conditions, First and Second Quarters 2012, Report II - Detailed Tables. Please note that we have adjusted some responses that were presented in the detailed tables in earlier reports.

2 In the first quarter 1.21% of loans and leases were 30 – 89 days past due and 4.11% were noncurrent, defined as 90 or more days past due or in nonaccrual. In the second quarter, 1.11% of loans and leases were 30 – 89 days past due and 3.89% were noncurrent. Federal Deposit Insurance Corporation (FDIC) Quarterly Banking Profile.

3 Mortgage Bankers Association's (MBA) National Delinquency Survey. The delinquency rate includes loans that are at least one payment past due but does not include loans in the process of foreclosure.

Capital constraints continued to loosen in the first quarter but tightened slightly in the second quarter. From the first quarter of 2011 through the first quarter of 2012, the percentage of CDFIs experiencing capital constraints fell each quarter from a high of 27% to a low of 11%. In the second quarter 2012, the rate went up slightly to 14% of respondents. At the same time, the percentage reporting increased access to capital year-over-year has declined each quarter since the third quarter of 2011's high of 52%, reaching 42% in the second quarter of 2012. The percentage reporting *decreased* access to capital grew from 8% in the first quarter to 13% in the second quarter.

Notwithstanding the fact that few CDFIs reported capital constraints, those that are constrained could have made an additional \$90 million in loans in the second quarter and an additional \$25 million in loans in the first quarter if financing capital were available. The bulk of these additional loans were from three organizations, although the largest one did not report needing capital in the first quarter. In addition, respondents project a \$468 million shortfall in financing capital over the next twelve months.

Portfolio Quality

Portfolio quality continued to improve in the first half of the year. After a slight increase in the first quarter to 5.9%, the average loans more than 30 days past due fell to 5.3%, the lowest level since we began collecting these data in 2008. Fifty one percent of the respondents in the second quarter said that they did not change their loan loss reserve ratio, also the highest rate on record. The percentage of loans or investments in workout increased for 23% of CDFIs in the first quarter and 16% in the second quarter. Both of these levels are well below the average of 44% from the fourth quarter of 2008 to the second quarter of 2010. The percent of loans restructured did increase to 6.3% in the second quarter, above the average of 5.5% for the last five quarters.

CDFIs remain cautiously optimistic about the future. Roughly 60% of CDFIs in the first and second quarter expected no change in portfolio quality.⁴ In the fourth quarter of 2011, nearly half (45%) of respondents expected portfolio quality to improve in the next quarter, the highest percentage since we began collecting these data and a jump up from the third quarter when 35% of CDFIs expected improved portfolio quality. This fourth quarter number was likely an anomaly as the first and second quarter data show 34% and 37% expecting improvements, respectively – both consistent with the third quarter of 2011 result of 35%.

⁴ 61% reported no change in the first quarter and 58% in the second quarter.

Among the survey respondents who commented on their expectations for the next quarter, the responses vary across regions and sectors:

*"We are experiencing tremendous growth in lending operations and need additional equity/grants to meet that demand."
(Housing to Organizations CDFI, located in the Northeast)*

*"Strong and steady year end expected."
(Housing to Organizations CDFI, located in the Midwest)*

*"We are only affected by our ability to raise equity to leverage more debt capital. Fortunately we have been able to access CDFI Fund FA grants that help leverage more debt. Our loan pipeline increases when we increase marketing, which we will now be able to do. The remainder of the year looks bright for us."
(Commercial Real Estate CDFI, located in the West)*

*"Insufficient capital to meet mortgage loan demands (portfolio) forcing sell back to secondary market."
(Consumer CDFI, located in the South)*

*"We are constrained in our ability to make more loans by lack of staff, however we cannot increase staff without increased operational support"
(MicroEnterprise CDFI, located in the Midwest)*

*"Availability of capital is not a constraint; however pricing and terms of capital create deployment challenges."
(Commercial Real Estate CDFI, located in the Northeast)*

*"People in New Mexico are in a holding pattern. Very few apps and lending has slowed considerably."
(Business CDFI, located in the West)*

*"A majority of our constraints are around obtaining necessary funding to help get new products in place to assist our members more efficiently."
(Consumer CDFI, located in the South)*

*"We have a significant amount of available capital and hope to increase lending in the coming quarters. Municipal and state budget constraints have hurt many of our borrowers, particularly in the early care industry."
(Community Services / Facilities CDFI, located in the Northeast)*

*"We continue to see an increase in delinquencies due to unemployment or family household changes. For borrowers underwater short sales or strategic defaults are the only option. We take the loss on the down payment assistance loans."
(Housing to Individuals CDFI, located in the West)*

CDFI Market Conditions, First and Second Quarters 2012

Report I – Results and Analysis

I. DEMAND FOR FINANCING AND LOAN ORIGINATIONS

Detailed Results

Growth in demand for financing continued to hold steady through the first and second quarters of 2012. The percentage of respondents experiencing a year-over-year increase in the number of financing applications received remained over 50% in both the first and second quarters of 2012. The percentage experiencing no change in applications grew from 14% at the end of 2011 to 22% in the first quarter and 21% in the second quarter. Housing to Individuals continued to show particular strength with 71% experiencing an increase in applications in the first quarter and 64% experiencing an increase in the second quarter.

Originations held steady in the first and second quarters of 2012 with 20% in the first quarter showing no change in the number of originations year-over-year before falling slightly to 18% in the second quarter. Twenty six percent reported a decrease in originations in the second quarter of 2012, the lowest on record. Among those CDFIs whose originations did not keep pace with financing applications in the second quarter, the primary reasons were weak application quality (28%) followed by increased due diligence (16%) and staff diverted to increased monitoring of existing portfolio (14%). Sectors reporting 60% or more increases in originations year-over-year in the second quarter are Commercial Real Estate, Housing to Organizations, and Microenterprise.

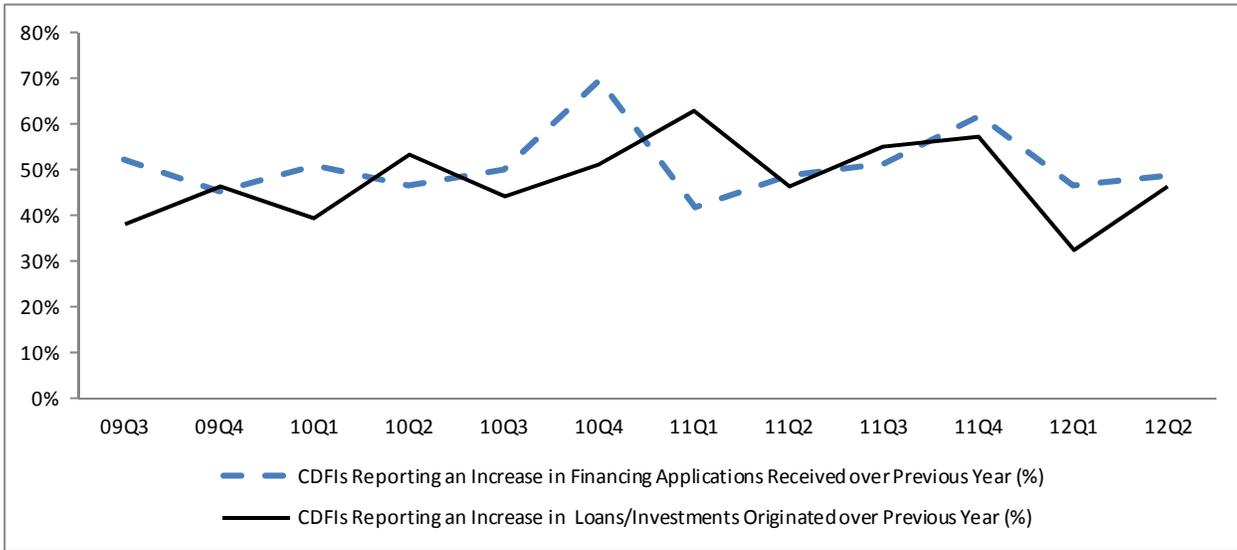
Trend Results⁵

In the first and second quarter of 2012, demand varied but the overall trend reflected stability after several quarters of significant increases as shown in the subset of 43 CDFIs in the trend analysis. In the first quarter of 2012, 47% reported an increase in the number of financing applications received year-over-year versus 33% who reported an increase in originations over the previous year. The first quarter level of 33% reporting increases in originations is the lowest on record. However, the second quarter climbed back to slightly under the long-term average of 51%, with 47% showing an increase in originations.

Most noticeable though is that the percentages experiencing no year-over-year change in applications and no change in originations were both high in the first and second quarter. In the first quarter, the percent experiencing no year-over-year change in originations reached 26%, the highest on record.

⁵ Complete findings for trend respondents are available in *CDFI Market Conditions, First and Second Quarters 2012, Report II – Detailed Tables*, Table V, pages 47-50.

Figure 1. CDFIs Reporting an Increase in Financing Applications versus Loans/Investments Originated, % Change Over Previous Year (n=43)



Outlook

Sixty nine percent of all respondents expect demand for financing to increase in the next quarter. Only 2% of respondents expect a decrease in demand for financing in the second quarter. In the first quarter, 1% expected a decrease in demand, the lowest rate recorded since we began reporting these data in the fourth quarter of 2008.

II. CAPITALIZATION AND LIQUIDITY

Detailed Results

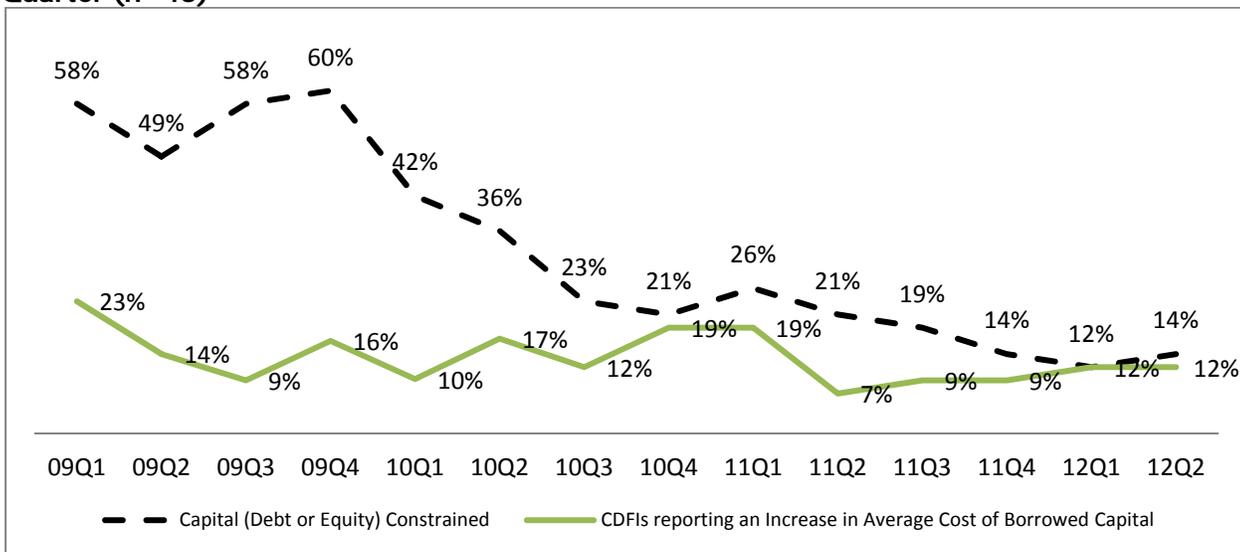
At the end of the second quarter, 14% of CDFIs reported that they are capital-constrained. This marks the tenth consecutive quarter that fewer than 30% of the survey respondents reported that they are capital-constrained and the fourth consecutive quarter that fewer than 20% of respondents reported that they are capital-constrained. Throughout 2011, more Small CDFIs reported being capital-constrained than Large or Medium CDFIs; in the first two quarters of 2012, the percentage of Small CDFIs fell and are now in line with the other asset sizes.

In the second quarter, 54% of CDFIs in the Northeast reported increased ability to access capital year-over-year. CDFIs in the South followed at 44% and the West (37%) and Midwest (32%) were both significantly lower. The South reported that only 3% had decreased ability to access capital year-over-year, well below the Midwest (14%), Northeast (17%), and West (23%).

Trend Results

In terms of capital liquidity among the trend sample, the data suggests a plateau. In the second quarter, 33% of trend respondents showed no change in capital liquidity year-over-year, the highest on record. In the fourth quarter of 2011, only 12% of respondents showed no change while 69% showed an increase in capital liquidity and 19% saw a decrease. In the first and second quarters of 2012, the percent showing an increase in capital liquidity decreased slightly to 58% and 51%, respectively. The percent showing a decrease dipped to 16% in both quarters, both the lowest on record.

Figure 2. Capital Constraints and Borrowing Costs Reported in Trend Results, % Change Over Previous Quarter (n=43)



Outlook

In the first and second quarters of 2012, 91% and 94% of all respondents, respectively, reported that they had greater than 90 days operating cash on hand. These are both the highest levels on record. Only once before has this rate reached 90%. The smaller trend sample reflects this outcome as well with 95% having more than 90 days of cash-on-hand in both the first and second quarters.

III. PORTFOLIO QUALITY

Detailed Results

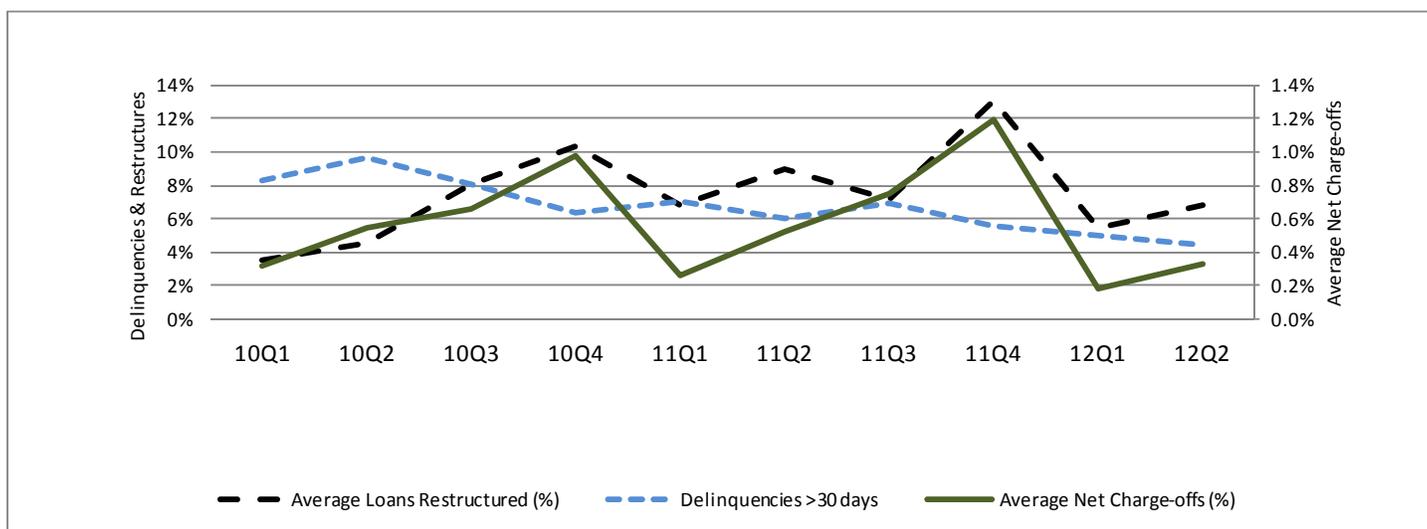
Consistent with the long-term trend, the second quarter of 2012 represented the lowest level of portfolio-at-risk (greater than 30 days delinquent) at 5.3%. At the same time, restructures produced mixed results. Average loans restructured were at 4.9% in the first quarter rising to 6.3% in the second quarter, yet ending lower than the 7.0% at year-end 2011 and the 7.7% at year-end 2010.

CDFIs in the Midwest reported the highest average portfolio-at-risk at 10.9% of the loan portfolio in the second quarter and the West had the lowest rate at 3.5%. In the sector breakout, Consumer (7.5%) and Housing to Individuals (8.2%) CDFIs reported high average portfolio-at-risk. Commercial Real Estate (2.1%) and Housing to Organizations (2.9%) had the lowest rates of average portfolio-at-risk.

Trend Results

The percentage of CDFIs in the trend sample reporting an increase in delinquency over the previous year remained at 29% in the first quarter before rising to 36% in the second quarter, close to the 2011 quarterly average of 33%. The graph below shows the gradual decline in average delinquencies greater than 30 days over the past eight quarters and the uneven increase in restructures during the same period. The figure also shows average net charge-offs well below the results from the end of 2011.

Figure 3. Average Trend Portfolio-at-Risk, Restructures, and Charge-offs (n=43)



Outlook

Most respondents expect portfolio quality to either improve (37%) or stay the same (58%) in the next quarter. The outlook on portfolio quality has stabilized over the life of the survey, with the percentage of CDFIs in the trend sample expecting deterioration falling from 45% in the fourth quarter of 2008⁶ to 10% in the second quarter of 2012.

⁶ Not shown in the tables. See previous quarterly reports for this figure.

Comparison to FDIC-Insured Institutions

In the previous sections, we analyzed average portfolio quality using a methodology that weighs each CDFI equally regardless of size. In this section, to compare CDFI industry portfolio quality to FDIC-insured institutions, we use the FDIC's methodology of analyzing the portfolio quality of the respondents as a whole. This method gives greater weight to larger CDFIs and lesser weight to smaller CDFIs.

CDFI industry portfolio quality improved slightly in the first quarter, with loans more than 30 days past due at 5.57% in the second quarter and 5.47% in the fourth quarter. (See Table A.)

Looking back, 2010 was the first year that the CDFI industry ended the year with higher net charge-offs than FDIC-insured institutions (2.85% vs. 2.54%). While annual net charge-offs fell in 2011 for both the CDFIs industry and FDIC-insured institutions, CDFIs ended the year higher than FDIC insured institutions (2.14% vs. 1.55%). In the second quarter of 2012, CDFI net charge-offs were lower than FDIC insured institutions (0.97% vs. 1.13%). While this may signal an important long-term change, it may also be due to changes in the composition of survey respondents: several CDFIs with substantial charge-offs in the fourth quarter of 2011 did not participate in the first and second quarter 2012 surveys. In addition, one large CDFI that constitutes over half of the reported charged-offs in 2011 reported has had significantly lower charge-offs in 2012.

Table A: CDFI Industry Portfolio Performance, All Survey Respondents ⁷															
	2012		2011				2010				2009				2008
	Q2	Q1	Q4	Q3	Q2 ⁸	Q1	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
n=	96	100	130	98	122	131	99	106	97	88	104	107	110	102	97
Net Charge-offs, year to date (annualized)	0.97	0.93	2.14	2.16	1.49	1.47	2.85	2.23	2.04	1.21	1.74	1.35	1.20	1.15	0.93
% 31-90 Days Past Due	1.84	1.94	2.29	1.67	1.93	4.09	3.10	2.94	3.98	4.95	5.27	4.43	5.20	4.52	6.82
% >90 Days Past Due or in Nonaccrual	3.63	3.63	3.64	4.79	4.53	6.19	5.68	5.93	6.60	7.85	6.63	5.94	6.40	4.44	3.09
% >30 Days Past Due ⁹	5.47	5.57	5.93	6.46	6.46	10.3	8.78	8.87	10.6	12.8	11.9	10.4	11.6	8.96	9.91
Table B: FDIC-Insured Institution Industry Portfolio Performance (n=8,000+)															
% Net Charge-offs, year to date (annualized)	1.13	1.17	1.55	1.61	1.70	2.55	2.54	2.59	2.74	2.84	2.49	2.38	2.24	1.94	1.28
Loans and Leases															
% 30-89 Days Past Due	1.11	1.21	1.35	1.37	1.38	1.52	1.61	1.68	1.69	1.92	1.93	1.92	1.85	2.04	2.01
% >=90 Days Past Due or in Nonaccrual	3.89	4.11	4.09	4.22	4.37	4.71	4.87	5.12	5.21	5.45	5.37	4.94	4.35	3.76	2.93
% >=30 Days Past Due	5.00	5.32	5.44	5.59	5.75	6.23	6.48	6.80	6.90	7.37	7.30	6.86	6.20	5.80	4.94

⁷ More information on calculations and methodology for the above analysis can be found in the companion report, *CDFI Market Conditions, First and Second Quarters 2012, Report II – Detailed Tables* in Appendix I page 51.

⁸ Please note that the first and second quarter 2011 rates have been adjusted to correct for a calculation error and therefore do not match the rates in the first and second quarter 2011 reports.

⁹ Prior to the first quarter 2010, the Market Conditions Survey did not ask CDFIs to report Additional Nonaccruals that they had not included in their greater than 90 days past due category; therefore, delinquencies prior to the first quarter 2010 do not include nonaccruals for some CDFIs.